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No. 91-1743

In the Supreme Court of the United States

OCTOBER TERM, 1992

UNITED MISSIONARY AVIATION, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Commissioner of Internal Revenue properly revoked petitioner's exempt status under Section 501(c)(3) of the Internal Revenue Code (26 U.S.C.), retroactive to December 31, 1973, on the ground that after that date petitioner's operations had a substantial commercial purpose substantially different from the purpose described to the Commissioner when he granted the exemption.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is unreported. The memorandum opinion of the United States Tax Court (Pet. App. 3a-21a) is reported at 60 T.C.M. (CCH) 1152.

JURISDICTION

The judgment of the court of appeals was entered on October 7, 1991. A petition for rehearing was denied on December 17, 1991. On March 11, 1992, Justice Blackmun extended the time for filing the petition to and including April 15, 1992. The petition was filed on that day. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1968, petitioner applied for exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. 501(c)(3), as a religious organization, describing its purpose as providing air transportation for missionaries. In a September 30, 1968, letter, the Commissioner of Internal Revenue granted petitioner tax-exempt status based on the information supplied by petitioner as to its purpose and operations; the letter indicated that the exemption was granted on the understanding that petitioner's operations would continue in the same manner and indicated that any changes in operation should be reported immediately to the Internal Revenue Service (IRS). As indicated in its exemption request, petitioner's primary activity initially was flying groups to and from mission fields about once every other month, for which it charged the cost of gasoline and oil. In 1969, however, petitioner sold its only airplane. Petitioner reported gross receipts for 1969 (including income from the sale of the airplane) of only $16,780. Pet. App. 4a-7a.

Although the parties dispute the nature of petitioner's activities during the ensuing years, it is clear that by 1974 petitioner was operating a substantial new division under the trade name Missionary Tape and Equipment Supply (MTES). The business operated through selling prerecorded tapes of religious speeches, as well as blank tapes and home entertainment equipment such as cassette players, amplifiers, calculators, and radios; prominent manufacturers whose products petitioner made available included Craig, Kodak, Sony, Sanyo, Hitachi, and Panasonic. Petitioner advertised its inventory in a lengthy catalog distributed to approximately 80,000 individuals on a mailing list supplied by the publisher; in the 1974 version, less than 20% of the catalog was

devoted to religious materials. The catalog claimed that petitioner was the largest distributor of bulk cassette tapes in the world. Petitioner reported receipts of $1,054,492.73 in 1974 and $906,211 in 1975, primarily from MTES. In September of 1975, petitioner sold MTES to an unrelated organization. Pet. App. 6a-12a.

2. The Commissioner audited petitioner for the years 1974 and 1975 and determined that petitioner's tax exempt status should be revoked, retroactively to December 31, 1973, because petitioner had been operated for a substantial commercial purpose and because petitioner's profits inured to the benefit of a private individual. Pet. App. 22a-23a; see *id.* at 20a.

3. Pursuant to Section 7428 of the Internal Revenue Code, petitioner sought review of the Commissioner's determination in the Tax Court. The Tax Court upheld the Commissioner's ruling. Pet. App. 3a-21a.

a. First, the Tax Court held that petitioner failed to qualify as an exempt organization for 1974 and 1975 because petitioner then had a nonexempt commercial purpose that was substantial in nature. Pet. App. 13a-20a. The court noted that the focus of the inquiry "is on the purpose toward which an activity is directed, rather than the nature of the activity itself," *id.* at 14a, and explained that "courts have generally focused on how an organization carries on its activities, implicitly reasoning that an end can be inferred from the chosen means," *id.* at 15a. Examining the manner in which petitioner carried on its business, it identified four factors of particular relevance to its determination in this case: first, that petitioner was operated in the same manner as any profitable commercial enterprise (*id.* at 15a-16a); second, that petitioner competed with other commercial firms (*id.* at 16a); third, that petitioner structured its pricing to realize a profit, charging about 20% above cost for a net profit

after expenses of 7.9 to 8.2% (*id.* at 16a-17a); [1] and fourth, that petitioner had substantial profits during the years at issue, as its net worth increased from $50,939 to $321,958 (*id.* at 17a-18a).

Petitioner claimed that it had an exempt purpose in accumulating its profits, but the Tax Court disagreed. The court held that petitioner "failed to meet its burden" of proving that the IRS erred in determining that petitioner was using its accumulated profits for a nonexempt purpose, noting that petitioner had not offered an adequate explanation of how it had disposed of the accumulated profits. Pet. App. 18a-19a. Because the court concluded that petitioner had a substantial nonexempt purpose, it did not reach the Commissioner's alternate argument that petitioner's profits inured to the benefit of a private individual. *Id.* at 20a.

b. The Tax Court also upheld the Commissioner's determination that the revocation of petitioner's exempt status should operate retroactively to the beginning of 1974. Pet. App. 20a-21a. The court explained that 26 C.F.R. 601.201(n)(6)(i) states that a ruling revoking exempt status may be applied retroactively "if the organization * * * operated in a manner materially different from that originally represented." Pet. App. 20a. It then found that "[o]n its application for exempt status, petitioner stated its purpose was to promote the Christian Gospel primarily by providing air transportation for missionaries and Christian workers. Respondent granted the exemption in 1968 based on this information and [on the] understanding that the continuing operation would conform." *Id.* at 21a. Only one year later, pe-

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[1] Although petitioner claimed that it "gave away large amounts of tapes and equipment to various religious organizations," the Tax Court rejected this claim because petitioner could not document donations totalling more than $10,000. Pet. App. 17a.

titioner disposed of its sole airplane. *Ibid.* Notwithstanding petitioner's claims that representatives of the IRS orally approved petitioner's activities, the court concluded that "petitioner did not inform respondent of its MTES division until filing its Form 990 for 1974." *Ibid.* Under these circumstances, the Tax Court held, the Commissioner did not abuse his discretion in retroactively revoking petitioner's exemption. *Ibid.*

4. The court of appeals summarily affirmed, stating: "After careful review of the record, we find no error in the tax court's decision. Accordingly, we affirm on the basis of the tax court's opinion." Pet. App. 1a-2a.

ARGUMENT

1. Section 501(a) of the Internal Revenue Code provides that an organization described in Section 501(c) shall be exempt from federal income taxation, subject to exceptions that are not relevant in this case. Section 501(c)(3) in turn describes, *inter alia*, corporations "organized and operated exclusively for religious * * * purposes." Section 1.501(c)(3)-1(c)(1) of the Commissioner's regulations provides that an organization is not considered to be operated exclusively for an exempt purpose "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." Thus, "the presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes." *Better Business Bureau, Inc.* v. *United States*, 326 U.S. 279, 283 (1945).

In this case, as the courts below found, petitioner's operations had a substantial nonexempt purpose, namely, a commercial purpose. The courts consistently have sustained the Commissioner's finding of a substantial commercial purpose when the facts establish that the organization operates like a commercial group, on the theory

that the means reveal the ends. See *Living Faith, Inc.* v. *Commissioner*, 950 F.2d 365, 372-373 (7th Cir. 1991) (citing cases). Similarly, high profits generally are taken as indicative of a for-profit purpose. See, *e.g.*, *Parker* v. *Commissioner*, 365 F.2d 792, 798 (8th Cir. 1966), cert. denied, 385 U.S. 1026 (1967). This factor is considered particularly relevant if, as here, the profits stem from the sale of goods or services and the organization makes little or no allowance for those unable to pay. See, *e.g.*, *Federation Pharmacy Services, Inc.* v. *Commissioner*, 625 F.2d 804, 807-808 (8th Cir. 1980). Other relevant factors include promotional methods, pricing policies, competition with taxpaying businesses, and other commercial practices that give the operation a "commercial hue." *Living Faith, Inc.*, 950 F.2d at 373; see *Parker*, 365 F.2d at 798; *Incorporated Trustees of the Gospel Worker Society* v. *United States*, 510 F. Supp. 374, 379 (D.D.C.), aff'd, 672 F.2d 894 (D.C. Cir. 1981), cert. denied, 456 U.S. 944 (1982).

The decision below is fully consistent with the principles applied in those cases. The Tax Court found that there was little to distinguish petitioner from any other commercial business operated for a profit. Specifically, the court found that petitioner purchased equipment for its inventory on credit through a manufacturer's representative; that the vast majority of items available from petitioner were neither religious in nature nor designed to be used by religious organizations; that petitioner advertised itself as the largest distributor of blank tapes in the world; that petitioner marketed through catalogs distributed to a mailing list supplied by the publisher; that petitioner competed with commercial, taxpaying businesses; that petitioner structured its pricing to realize a profit, and for tax years 1974 and 1975 reported net profits of $173,438 and $97,582, respectively; that petitioner did little to help those unable to pay to obtain the

merchandise but instead accumulated profits for no explained exempt purpose. Pet. App. 15a-18a. The court of appeals examined the record and sustained the Tax Court's findings of fact.

Petitioner's main challenge to the decision of the court of appeals, repeated in various formulations throughout the petition (see, *e.g.*, Pet. 8-9, 28-33), is that the courts improperly failed to consider the purpose of its activity, because they relied so heavily on their conclusions regarding the manner in which petitioner conducted its activities. The problem with this argument, however, is that petitioner cannot deny that the manner in which petitioner conducted its activities is certainly a relevant factor—if not the best indicator—in ascertaining the purpose of those activities. Neither the Commissioner nor the courts should be bound by petitioner's self-serving statements that it has only exempt purposes when those statements are belied by the objective facts. See *Living Faith, Inc.*, 950 F.2d at 372 ("Put simply, saying one's purpose is exclusively religious doesn't necessarily make it so."). As the summary above makes clear, the evidence in this case supplied considerable objective support to the conclusion of the courts that petitioner had some substantial commercial purpose for those activities.

Petitioner errs in claiming (Pet. 20-33) that the decision of the courts below establishes the rule that activity of a commercial nature, without more, necessarily destroys an organization's exemption. The opinion of the Tax Court states that "our focus is on the purpose toward which an activity is directed, rather than the nature of the activity itself." Pet. App. 14a. Petitioner identifies nothing in the subsequent analysis of the court that undermines this statement; instead, petitioner merely challenges the inferences the court drew from the manner in which petitioner conducted the activ-

ity. In these circumstances, there is no reason to believe that the summary decision of the court of appeals, upholding the Tax Court's factbound determination, raises a question of general legal significance.

Petitioner also errs in contending (Pet. 8-19) that the decision of the court of appeals conflicts with the Third Circuit's decision in *Presbyterian & Reformed Publishing Co.* v. *Commissioner*, 743 F.2d 148 (1984). That case involved revocation of the tax exempt status of a religiously oriented publishing house. Due to the sudden popularity of one of its authors, the taxpayer became highly profitable. The taxpayer notified the IRS that it intended to accumulate its profits in order to expand its operations, which theretofore had been run out of the principal's kitchen. See *id.* at 150-151. The Tax Court, relying primarily on the fact that the taxpayer had accumulated its profits, determined that the taxpayer was operated for a substantial commercial purpose. See *id.* at 152, 156.

The court of appeals reversed, holding that, under the circumstances presented in that case, the accumulation of profits, standing alone, was inadequate to support a finding of a substantial commercial purpose. The Third Circuit accepted the relevance of a variety of objective factors regarding the manner of operation, such as an increase in commercial activity, the accumulation of capital, profitability, and the development of a staff, 743 F.2d at 152, 155, 157, but reversed the Tax Court's decision for an overly inflexible reliance on a single factor: the accumulation of the profits of the activity. The court of appeals noted that the Tax Court failed to address the substantial evidence of an exempt reason for that accumulation, evidenced by the taxpayer's notification to the IRS that it would retain profits to expand its physical capacity. Hence, because the expanded physical capacity would allow the taxpayer to disseminate more

religious works, the accumulation of funds would serve an exempt purpose. *Id.* at 155-158.

By contrast, petitioner did not notify the IRS that it intended to accumulate profits, and it never satisfactorily explained what it in fact did with the profits. See Pet. App. 18a-19a. Even if the Tax Court had credited petitioner's explanation (Pet. 15) that it used its profits to build up its inventory, this explanation would not suffice, because it is entirely consistent with the practice of a commercial business seeking to expand its profits and identifies no exempt purpose served by the accumulation.

2. Petitioner also claims (Pet. 33-38) that the courts below erred in finding that the Commissioner did not abuse his discretion by retroactively revoking petitioner's exempt status effective December 31, 1973. Pursuant to Section 7805(b) of the Internal Revenue Code, the Commissioner is vested with discretion to determine the extent to which his rulings will apply retroactively. Regulations expressly provide that a substantial change in operations is an appropriate basis for retroactive revocation. See 26 C.F.R. 601.201(n)(6)(i). Moreover, contrary to petitioner's suggestion (Pet. 35-38), it is the taxpayer's burden to show that it is entitled to exemption from tax; the Commissioner's rulings in this area will be upheld absent an abuse of discretion. *Automobile Club* v. *Commissioner*, 353 U.S. 180, 184-185 (1957); see *Living Faith, Inc.*, 950 F.2d at 370; *United States* v. *Dykema*, 666 F.2d 1096, 1099 n.3 (7th Cir. 1981), cert. denied, 456 U.S. 983 (1982).

The exemption application petitioner submitted in 1968 represented that petitioner would provide air transportation to mission fields in exchange for the cost of oil and gasoline. It did not mention a tape and electronic

business.[2] The exemption was granted on the express condition that petitioner adhere to its limited purpose. Yet, only one year later, petitioner disposed of its sole airplane and thereafter engaged in a substantial tape and electronic supply business. Pet. App. 21a. In these circumstances, petitioner has not carried its burden of establishing that the revocation should apply without retroactive effect. Petitioner's factbound claim to the contrary does not warrant review by this Court.[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[2] Although petitioner suggests that it advised IRS employees of its planned operations from the very beginning, and claims that it relied in good faith on "the further assurances it received from IRS personnel," Pet. 37, the Tax Court found that "petititioner did not inform [the IRS] of its MTES division until filing its Form 990 for 1974." Pet. App. 21a.

[3] Petitioner errs in stating (Pet. 35) that the IRS articulated the "rationale for making this decision retroactive * * * only at the final level of administrative appeal." The proposed adverse determination letter issued by the IRS examining agent concluded that petitioner's exempt status should be revoked as of December 31, 1973, because petitioner was engaged primarily in commercial rather than religious activities. See Gov't C.A. Br. 10.